Rational investors sit it out

Money Matters

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For this week's article I am going to ask you to pretend you are living in a make-believe world, which shouldn't be too hard, just follow our supreme leaders' example by living in denial until you believe your own lies.

But that's a topic for another week.

Let's pretend we are living on the moon, which may not be that far off.

Unfortunately, the moon doesn't offer many investment opportunities, since Elon Musk and NASA own everything, so we must invest in the world down below.

The question is how much of our portfolio we will invest in South Africa, pretending one has never heard of the Guptas, Zuma and the term "state capture".

I know that's a tall ask, but try hard, all things pass and hopefully, one day so too will the aforementioned. Rather keep in mind that SA makes up only 0,4% of the world economy.

As a global investor, I would argue that your allocation to SA should be the same as SA's share of the world economy (0,4%), unless there were unique investment opportunities, which you couldn't access elsewhere or if SA was offering compelling value against other regions, then you might increase the weight a bit.

Why is it then that the average SA investor has approximately 75% of their wealth invested in SA?

The reason for this is a piece of legislation called Regulation 28, which prescribes prudential investment guidelines for retirement funds. Regulation 28 limits the offshore exposure of retirement funds to a maximum of 25%.

The theory behind this rule is to limit the risk, which retirement funds can take, to protect retirement fund members.

Unfortunately, the regulators have no understanding of risk.

They mistakenly define risk as volatility of return, when it should be defined as the permanent loss of capital. Short-term volatility, usually triggered by an unforeseen event, causes a temporary loss of capital.

The market crashes as investor fear leads to panic and motivates irrational selling. A rational investor must simply sit tight and wait for the panic to subside and prices to recover – this means no permanent loss only temporary.

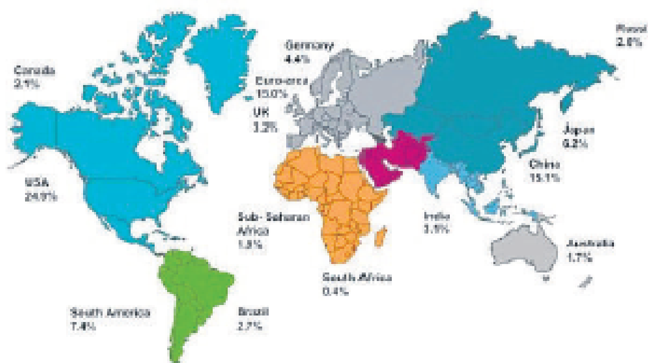
Dave Foord, chief investment officer at Foord Asset Management, has been very critical and outspoken on Regulation 28 guidelines, which he refers to as the cost of legislation resulting in lower returns for investors.

This is clear if you compare the five-year returns of the Foord Balanced Fund (Regulation 28 compliant) = 10,8% to the Foord Flexible Fund (non-Regulation 28 compliant) = 14,9%, thus the prescribed investment rules of Regulation 28 cost the investor 4,1% in lower returns.

It is quite normal for investors to perceive investments in their home country as lower risk, commonly referred to as home bias. But this is only a bias, particularly in SA.

SA investors should use their discretionary savings to increase offshore exposure. I must add, though, that the JSE has some phenomenal global businesses, which provide SA investors with indirect offshore exposure via these Rand hedge shares. – *www.markwilliams.co.za*

Breakdown of the world economy – estimated in 2017



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